

DOCKET SECTION

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

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Postal Rate and Fee Changes, 1997

Docket No. R97-1

**NEWSPAPER ASSOCIATION OF AMERICA
WITNESS SHARON CHOWN
ANSWERS TO INTERROGATORIES OF
ADVO, INC. (ADVO/NAA-T1-1-10)
February 9, 1998**

The Newspaper Association of America hereby provides answers of witness Sharon Chown to the interrogatories of Advo, Inc. (ADVO/NAA-T1-1-10), filed on January 26, 1998. Each interrogatory is stated verbatim and is followed by the answer. A declaration is attached.

Respectfully submitted,

NEWSPAPER ASSOCIATION OF AMERICA

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CERTIFICATE OF SERVICE

I hereby certify that I have this date served the instant document on all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

February 9, 1998


William B. Baker

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ADVO/NAA-T1-1. Please confirm that, of all rate classes and categories listed in Exhibits NAA-1B and 1E, the two that have the highest ratio of "weighted attributable costs" to actual attributable costs are In-County Periodicals and Standard A Commercial ECR.

Answer:

Not confirmed. Mailgrams actually have the highest ratio of "weighted attributable costs" to actual attributable costs. Standard A Commercial ECR and In-County Periodicals have the second and third highest ratios, respectively.

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ADVO/NAA-T1-2. At page 19, you state that "Standard A ECR mailers depend primarily on the delivery function."

- (a) Is the same true of In-County Periodicals mailers?
- (b) Please confirm that, according to your Exhibit NAA-1B, delivery costs account for approximately 67 percent of the total attributable costs of In-County Periodicals.
- (c) Please confirm that In-County Periodicals mailers consist predominantly of daily and weekly newspapers. If you cannot confirm because you do not know, please state whether you have any basis to disagree that In-County mail consists predominantly of daily and weekly newspapers, and identify the basis for your disagreement.

Answer:

- (a) Yes.
- (b) Confirmed.
- (c) Confirmed.

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ADVO/NAA-T1-3. Please confirm the following with respect to In-County Periodicals and Standard A ECR mail:

- (a) The "weighted attributable costs" you calculate for In-County Periodicals, \$129.401 million, is \$48.041 million (or 59 percent) greater than In-County attributable costs.
- (b) The \$129.401 million "weighted attributable costs" you calculate for In-County Periodicals is almost \$46 million greater than the total revenues from In-County mail at the USPS proposed rates.
- (c) The \$3,111.033 million "weighted attributable costs" you calculate for Standard A ECR is \$1,190 million less than the total revenues from ECR mail at the USPS proposed rates.
- (d) At the USPS proposed rates, please confirm that ECR mail would generate revenues substantially greater than your calculated "weighted attributable costs" whereas In-County Periodicals would generate revenues substantially less than your "weighted attributable costs."

Answer:

- (a) Confirmed.
- (b) Confirmed.
- (c) Confirmed.
- (d) Weighted attributable costs are not a substitute for the actual attributable costs to be recovered from a subclass of mail, as required by the Act. I propose that the Commission use weighted attributable costs only in assigning institutional costs. As long as revenues exceed actual (unweighted) attributable costs, the subclass is making a positive contribution to the institutional costs of the Postal Service.

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With the understanding that the comparison that you are making is not useful, I confirm that the revenues at USPS proposed rates from ECR mail are greater than the weighted attributable costs, and that the revenues from in-county mail are less than weighted attributable costs.

As you've not defined the word "substantial," I cannot state whether these differences are substantial or not. See also my answers to ADVO/NAA-T1-6 (a) & (b) and AMMA/NAA-T1-6(b).

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ADVO/NAA-T1-4. To facilitate a comparison of your Docket No. R90-1 proposed approach with your current approach, please provide the following:

- (a) An itemization of all the differences between your Docket No. R90-1 proposed approach and your current proposed approach.
- (b) Using your example in Table 5 and Tables 6/7/8, a demonstration of how the institutional cost contributions for the three classes would be calculated under both (R97-1 and R90-1) approaches if there is not equal markup but rather Class C receives a markup approximately twice as large as that for the other two.

Answer:

- (a) First, both my Docket No. R90-1 method and my current proposed approach identify the attributable and institutional costs associated with the basic functions provided by the Postal Service. In Docket No. R90-1, I identified three basic functions -- mail processing, transportation and delivery. In this proceeding, I identify four basic functions. I have added "window service" as a separate function.

Second, in Docket No. R90-1, I separately analyzed each cost component of the Postal Service to identify the costs associated with each of the three basic functions. In this proceeding, I identify the direct costs associated with each function and employ the Postal Service's piggyback factors to identify the remaining costs associated with that function. In so doing, more of the total attributable costs of the Postal Service are

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identified with the four functions in my direct testimony in this proceeding, leaving fewer costs in the "administrative" or "other" cost category.

Third, in Docket No. R90-1, I proposed that the institutional costs associated with each function be assigned to subclasses of mail based upon the attributable costs of that function only. The remaining system-wide institutional costs were assigned based upon the total attributable costs. In this proceeding, my method does not assign the institutional costs associated with each function based upon the attributable costs of that function only. Instead, I am proposing that the total institutional cost pool be assigned to subclasses using the "weighted attributable costs" of each subclass. The weights reflect the percentage of the costs of the function that are institutional in nature, relative to the attributable costs of the function. Thus, my method in this proceeding requires a single judgmental assignment of total institutional costs based upon the weighted attributable costs, rather than the four-step assignment of institutional costs I proposed in Docket No. R90-1.

- (b) Assuming Class C receives a markup approximately twice as large as the other two classes across all functions, the following institutional cost contributions would result using my Docket No. R90-1 methodology:

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Table 1 (based upon Table 5 in Direct Testimony)							
Example: Unbundled Method of Assigning Institutional Costs							
	Function 1			Function 2			Total
	Attributable	Markup	Institutional	Attributable	Markup	Institutional	Contribution
Class A	\$75	20%	\$15	\$50	80%	\$40	\$55
Class B	\$75	20%	\$15	0	80%	0	\$15
Class C	0	40%	0	\$50	160%	\$80	\$80
Total	\$150	20%	\$30	\$100	120%	\$120	\$150

Again assuming that Class C receives a total markup twice as large as the other two classes, my current proposal would result in the following institutional cost contributions:

Table 2 (based upon Table 8 in Direct Testimony)			
Example: Institutional Cost Assignment using Weighted Attributable Costs			
	Weighted Attributable Costs	Markup	Institutional Cost Contribution
Class A	\$125	42.86%	\$53.6
Class B	\$25	42.86%	\$10.7
Class C	\$100	85.72%	\$85.7
Total	\$250	60%	\$150.0

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ADVO/NAA-T1-5. On page 17, you state:

"...this method of assigning institutional costs does not replace the essential role of judgment with any mechanistic method. Instead, this method provides a better cost figure to which the Commission can apply its judgment."

Please confirm the following. If you cannot confirm, please explain why not.

- (a) Your current proposal weights the attributable costs from each of four cost pools on the basis of the ratio of that cost pool's institutional costs to system-wide institutional costs.
- (b) Your current proposal, assuming equal mark-up of the "weighted attributable costs," generates the same results as your R90-1 proposal, assuming equal mark-up of attributable costs within each cost pool.
- (c) Under your proposal, the Commission would develop mark-up percentages that would be applied to subclass "weighted attributable costs" in order to develop the subclass contribution.
- (d) Under your proposal, once the Commission developed mark-up percentages and subclass contributions on the basis of "weighted attributable costs," it would then have to add the subclass contribution amount to the subclass unweighted attributable cost in order to develop subclass revenue requirement.
- (e) Under your proposal, if the Commission wanted to determine how alternative mark-ups would affect subclass rates, it would have to apply those mark-ups to the "weighted attributable costs," derive the contributions, and then add the contributions to the unweighted attributable costs.

Answer:

- (a) Not confirmed. As explained at page 18, lines 7-8, the weighting factors for each of the attributable cost pools equal the percentage of identifiable

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institutional costs divided by the percentage of attributable costs associated with providing each function.

- (b) Confirmed. The same results will be generated using my Docket No. R90-1 approach and my current proposed approach to institutional cost assignment *if you assume equal markups for all subclasses*. I use equal markups for illustrative purposes only. Historically, the Commission has never selected equal markups for all subclasses.
- (c) Confirmed.
- (d) Confirmed.
- (e) Confirmed.

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ADVO/NAA-T1-6. With respect to your proposal,

- (a) Please explain the underlying economic significance of your "weighted attributable costs."
- (b) Please explain the underlying economic significance of the "weighted attributable costs" plus contribution amount.
- (c) In considering application of the statutory factors for institutional cost assignment, should the Commission view your "weighted attributable costs" any differently than the unweighted attributable costs? If so, please explain why and how the Commission should view these figures differently. If not, please explain why not.
- (d) With regard to your proposed approach, would it [be] appropriate to apply the same relative percentage mark-ups or indices that the USPS or Commission would use with unweighted attributable costs to your proposed "weighted attributable costs"? If so, please explain why. If not, please explain why not.

Answer:

- (a) As this metric is used to assign institutional costs only, "weighted attributable costs" have no underlying economic significance beyond the fact that they are a better measure of how each subclass of mail benefits from institutional effort.

The current reliance on unweighted attributable costs for assigning institutional costs assumes that each dollar of attributable costs should be given equal weight when assigning institutional costs. Thus, a dollar of attributable mail processing costs is given the same weight as a dollar of attributable delivery costs, even though the provision of the delivery

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function accounts for a far greater share of the institutional costs of the Postal Service. Using unweighted attributable costs as the basis for the markups implicitly assumes that institutional costs are incurred to provide the different functions of the Postal Service in proportion to the attributable costs of these functions. As explained in my direct testimony, this assumption is not valid. As shown at page 9 (see, in particular, Table 3 at page 9), the distribution of institutional costs across the various functions are very different from the distribution of attributable costs. Therefore, in my view, it is inappropriate to give equal weight to each dollar of attributable cost. Weighting the attributable costs of the various functions in the manner I propose provides a better measure of how the different subclasses of mail benefit from institutional effort.

- (b) Unweighted attributable costs plus the contribution amount will equal the revenues to be recovered from each subclass of mail. The sum of the "weighted attributable costs" and the contribution amount has no underlying economic significance, and this sum is not used in my method.
- (c) I cannot answer this question as I am not privy to how the Commission currently views unweighted attributable costs when applying the statutory factors for institutional cost assignment.

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If, in the past, the Commission viewed unweighted attributable costs as a reliable measure of how much the various subclasses of mail benefited from institutional effort, then I believe the Commission should view weighted attributable costs no differently when applying the statutory factors for institutional cost assignment. If, however, the Commission viewed unweighted attributable costs as an inaccurate measure of how much the various subclasses of mail benefited from institutional effort, then I think the Commission should view weighted attributable costs differently, as the weighted attributable costs are a more accurate measure of how each subclass of mail benefits from institutional effort.

- (d) Again, I cannot answer this question as I am not privy to the Commission's or the Postal Service's thoughts when selecting markups for assigning institutional costs based on unweighted attributable costs. See (c) above.

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ADVO/NAA-T1-7. For Standard A ECR mail, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$1,885.248 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$3,111.033 million, an amount that is \$1,225.785 million (or 65 percent) greater than ECR attributable costs. If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

- (a) Please confirm that this extra \$1,225.785 million amount allocated to ECR is not part of the attributable costs of ECR mail. If you cannot confirm, explain why not, including a full explanation of why this extra amount should be treated as "attributable" to ECR mail.
- (b) Does this extra \$1,225.785 million amount allocated to ECR constitute a portion of USPS institutional costs that are reallocated by your method to ECR mail?
- (c) Does this extra \$1,225.785 million amount allocated to ECR constitute a portion of the attributable costs of other classes or subclasses of mail, such as First Class Mail, that are reallocated by your method to ECR mail?
- (d) If you claim in Answer to (a) - (c) above that this extra \$1,225.785 million amount is neither an attributable cost of ECR, nor a portion of institutional costs reallocated to ECR, nor a portion of attributable costs of other mail subclasses reallocated to ECR, please explain what kind of "costs" this amount represents.

Answer:

Confirmed.

- (a) I confirm that the "extra \$1,225.785 million amount" should not be included in attributable costs for any purpose other than assigning institutional costs.

My method does not "allocate" an extra \$1,225.785 million in costs to Standard A ECR mail. My method gives greater weight to the actual

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attributable costs of Standard A ECR mail *for the purposes of assigning institutional costs* because the subclass heavily relies upon functions which account for a large share of the institutional costs of the Postal Service.

- (b) No.
- (c) No.
- (d) The extra "costs" are not costs of any type. As explained in my Answer to ADVO/NAA-T1-6(a), each dollar of attributable costs does not result in the same institutional cost effort. Hence, my metric weights the attributable costs of each subclass in order to make the figures more comparable to the attributable costs of other subclasses *for institutional cost assignment purposes only*.

My method does not change the dollar amount of costs attributed to a subclass. Instead, my method simply recognizes that each dollar of attributable costs should not be given the same weight when assigning institutional costs as explained in my Answer to ADVO/NAA-T1-6(a).

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ADVO/NAA-T1-8. Please refer to Exhibit NAA-1E, where you calculate a "weighted markup" of 77.75 percent for Standard A ECR mail at the USPS proposed rates.

- (a) Please confirm that you derived this "weighted markup" by dividing the ECR contribution to institutional costs at USPS proposed rates by your calculated \$3,111.033 million "weighted attributable costs" for ECR.
- (b) Please confirm that your divisor is 65 percent greater than the attributable costs of ECR mail as shown in your Exhibit NAA-1B.
- (c) Please confirm that your resulting "weighted markup" represents ECR total contribution to institutional costs divided by a number that includes both (i) total ECR attributable costs plus (ii) a portion of either the institutional costs or attributable costs of other subclasses that have been reallocated by you to ECR mail.

If you cannot confirm any of the above, explain why not.

Answer:

- (a) Confirmed.
- (b) Confirmed.
- (c) Not confirmed. Please see my Answer to ADVO/NAA-T1-7(a) and (d).

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ADVO/NAA-T1-9. For First Class Letters, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$16,805.748 million, whereas your Exhibit NAA-1D shows "weighted attributable costs of \$16,455.049 million, an amount that is \$350.699 million (or 2.1 percent) less than First Class Letters attributable costs. If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

- (a) Please confirm that this \$350.699 million amount that is deducted from First Class Letter mail under your method is a part of the attributable costs of First Class Letter mail. If you cannot confirm, explain why not, including a full explanation of why this amount should be considered as part of the attributable costs of First Class Letter mail.
- (b) Please confirm that this \$350.699 million of attributable First Class Letters that is deducted from First Class Letters is, under your method, reallocated to other classes or subclasses of mail, such as ECR mail. If you cannot confirm, please explain the nature of this \$350.699 million amount (i.e., attributable costs of First Class Letters, attributable costs of other specific subclasses, or institutional costs), and explain what happens to these costs under your method (i.e., reclassified as institutional costs, reallocated to other subclasses, vanishing costs).

Answer:

Confirmed.

- (a) No costs have been "deducted" from First Class Letter mail attributable costs. The attributable costs have been weighted to reflect the mix of the functions used by First Class Mail and the institutional costs associated with those functions. The fact that the weighted attributable costs for First Class Letter mail are slightly less than the actual attributable costs of the

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subclass reflects the fact that the mix of functions used by First Class Letter mailers requires less institutional effort than the average. As explained in my Answer to ADVO/NAA-T1-7(d), these weighted attributable costs should be used for institutional costs assignment purposes only. My method does not change the dollar amount of the attributable costs to be recovered from each subclass of mail.

(b) Not confirmed. See my Answer to ADVO/NAA-T1-7.

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ADVO/NAA-T1-10. With respect to Priority Mail and Parcel Post, please confirm the following:

- (a) For Priority Mail, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$2,266.217 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$1,343.833 million, an amount that is \$922.384 million (or nearly 47 percent) less than Priority Mail attributable costs.
- (b) For Parcel Post, please confirm that your Exhibit NAA-1B shows total TYAR attributable costs of \$753.327 million, whereas your Exhibit NAA-1D shows "weighted attributable costs" of \$531.757 million, an amount that is \$221.570 million (or 29 percent) less than Parcel Post attributable costs.

If you cannot confirm, please explain why not, provide the figures that you believe to be correct, and show how they are derived from your exhibits.

Answer:

- (a) I can confirm your cost figures, but the "weighted attributable costs" are nearly 41 percent (rather than 47 percent) less than the Priority Mail attributable costs.
- (b) Confirmed.

DECLARATION

I, Sharon L. Chown, declare under penalty of perjury that the foregoing answers are true and correct, to the best of my knowledge, information and belief.

A handwritten signature in black ink, appearing to read 'S. Chown', is written over a horizontal line.

Date: 2/9/98